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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. ~~731~~ 55

INDIANA DEPARTMENT OF STATE REVENUE, GROSS INCOME TAX DIVISION, STATE OF INDIANA, *Petitioner,*

vs.

MARK E. NEBEKER, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF INDIANA

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vs.

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PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF INDIANA

MAY IT PLEASE THE COURT:

The Gross Income Tax Division of the Indiana Department of State Revenue of the State of Indiana, petitioner herein, respectfully prays that a Writ of Certiorari issue to review the opinion, decision and judgment of the Supreme Court of Indiana (by its majority opinion), entered in the above-entitled case on December 15, 1953.

Summary Statement of the Matter Involved

The Nature of the Action:

This action, commenced in the Vermillion Circuit Court of Vermillion County, Indiana (47th Judicial Circuit of Indiana), and thereafter appealed to the Supreme Court of Indiana, is one to recover taxes imposed upon the receipt of capital *gains* by respondent, domiciled and residing in Indiana, derived from his marginal stock transactions.

The Facts:

The facts are embodied in two Stipulations of Facts entered of record in the trial court, and may be found in the record submitted herewith at pages 5 to 12, inclusive ("Stipulation of Facts") and Pages 22 and 23 (supplementary "Stipulation").

So much of the facts as are necessary for a complete understanding of the questions herein presented are as follows:

Respondent is a resident of Indiana (R. p. 9, ll. 15-17). During the years 1944, 1945 and 1946, respondent consummated certain stock transactions through the stock brokerage firms of Thomson and McKinnon and/or James E. Bennett and Company (R. p. 9, l. 18 to p. 11, l. 33, inclusive). In each of said transactions, the purchase of said stock was made by the broker, the stock credited to the account of respondent on the books of the broker and the cost thereof debited to the account of respondent on the books of the broker kept in the State of Indiana. The stock certificates were never ordered out or transferred to respondent, nor were they ever delivered to respondent in a street name, but the property interest in such stock was maintained in what is commonly called a margin account (R. p. 11, l. 38 to p. 12, l. 2).

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The respondent had the right to receive the dividends paid on such stock, the right to vote or direct the vote of such stock in stockholders' meetings, and the right to sell the same and receive the proceeds. The rights of ownership thereto are subject only to the terms of a pledge to the broker for the payment of any indebtedness which might be owing by respondent to the broker (R. p. 12, ll. 3-10).

Upon orders of respondent, sales of such stock were made by the broker, who debited the stock sold to the account of the respondent, and the proceeds therefrom were credited to the respondent's account on the books of the broker kept in the State of Indiana (R. p. 12, ll. 11-16). Such transactions and the gains derived therefrom were as follows:

Years	*Number of Sales*	*Shares Sold*	*Gains*
1944	32	3310	$8,839.74
1945	31	3200	14,699.82
1946	13	1250	7,425.44

(R. p. 9, l. 18 to p. 11, l. 29, inclusive)

For each of said years, respondent reported such *gains* in his tax returns as "capital gains without deductions or losses (margin account)" (R. p. 6, ll. 5-17, inclusive). The amounts of tax paid on said "gains" and of which a refund is sought herein are as follows:

Year	*Amount claimed as Refund*
1944	$88.39
1945	146.99
1946	74.23

(R. p. 10, ll. 13-16, inclusive;
p. 11, ll. 1-7, inclusive;
p. 11, ll. 34-37, inclusive;
p. 7, l. 19 to p. 8, inclusive).

In addition to the tax herein involved, respondent paid intangibles tax to the State of Indiana on the securities herein, the liability for which is not in issue (R. p. 23, ll. 2-8, inclusive).

Opinions Below

The majority opinion, decision and judgment of the Indiana Supreme Court (R. p. 27, l. 23 to p. 28, l. 32, inclusive) and the dissenting opinion of EMMERT, J., in which DRAPER, C. J. concurred (R. p. 28, l. 33 to p. 32, l. 26), as yet unreported officially, are unofficially reported in 116 N. E. (2d) 104 of the West Reporter System, and are reproduced herein as "Appendix A" and "Appendix B" respectively, of this petition.

Statute and Regulations Involved

The statute involved is the Indiana Gross Income Tax Act of 1933, as amended (Indiana Acts of 1933, Chapter 50; Indiana Acts of 1937, Chapter 117, and succeeding amendatory acts), and may be found complete with amendments to date in Burns' Indiana Statutes Annotated, 1951 Replacement, Vol. 11, Part 2, Sections 64-2601 to 64-2635, both inclusive. Pertinent provisions of said Act are reproduced herein as "Appendix C" of this petition.

The specific regulations of petitioner, under which the tax herein was paid, as last promulgated on April 27, 1946, are as follows:

Regulation 2805:

> "MARGINAL TRANSACTIONS. Any taxpayer dealing on margin will report his gross earnings from such transactions. Gross earnings in such cases will be the gross profits realized, whether received or credited to his account, where securities or commodities are sold for any

amount in excess of cost, without any deductions for losses incurred when securities or commodities are sold for an amount less than cost, and also without any deductions for taxes, brokerage commissions or other expenses incident to the transaction."

Regulation 1005:

"Gross Earnings Means Generally the gross profits on individual transactions before costs of effecting the transactions are deducted, and with reference to sales of property such gross earnings means and includes only the gross difference between the cost of such property, as of the date of its final acquisition by the taxpayer, and the *gross* receipts resulting from the sale of such property. It also includes gross commissions, interest, dividends, fees, etc. In computing "gross earnings" no deductions can be taken for losses on any transactions. "Gross Earnings" is stipulated as being the "Gross Income" for taxation of banks, trust companies, building and loan associations, brokers, dealers in securities, finance companies, dealers in commercial paper, and persons engaged in the business of lending money or credit. (Sec. 1n; Sec. 1p.)"

The foregoing regulations in substance are the same as the corresponding regulations which have been in effect since July 1, 1934, excepting only minor variations in wording and identified by different numbers.

Jurisdiction

The issue of alleged interstate commerce immunity as applied to the receipts of respondent's capital gains herein was raised in the Court of the first instance in the Vermillion Circuit Court of Vermillion County, Indiana, by the filing of respondent's second amended complaint on October 1, 1951 (numerical paragraph 16 thereof.) (R. p. 14, l. 1 to p. 19, l. 20, inclusive). Said complaint is based

solely upon the allegation of interstate commerce immunity. This cause was put at issue in the trial court by the filing of petitioner's answer of denial. (R. p. 20).

Upon the admission and conclusion of evidence, and submission of the cause, the Court of first instance entered its general finding that the allegations of respondent's complaint were true and judgment for respondent that the income herein was immune from taxation by virtue of the Commerce Clause. (R. p. 25, ll. 1-28, inclusive)

The question of alleged interstate commerce immunity was pursued by petitioner from the Court of first instance by the filing of petitioner's Motion for New Trial, (R. p. 25, l. 32 to p. 26, l. 8 inclusive), which was overruled by said Court. (R. p. 26, ll. 13-25, inclusive). Thereafter, the question of alleged interstate commerce immunity was submitted to the Indiana Supreme Court by the filing of the Transcript of the Record, together with petitioner's Assignment of Errors. (R. p. 1). After briefing and argument, the Indiana Supreme Court, on December 15, 1953, by a divided Court, entered its written opinion, decision and judgment, based solely on the question of interstate commerce immunity, in which said majority opinion it concluded as follows:

> "• • • As the Supreme Court of the United States pointed out in the case of *Freeman* v. *Hewit*, *supra*, the vital question in each case is whether the *sale itself* was in the field of inter-state commerce. The evidence of the transaction may float around the world or stay safely buried in a gilded vault on Wall Street. It seems to us to make no decisive difference.
>
> "The trial court held that the facts in this case bring it within the rule laid down in the *Freeman Case*. We think the trial court was correct.
>
> "Judgment affirmed.

"Emmert, J. dissents with an opinion; Draper, C. J. concurs in dissent." (116 N. E. (2d) at p. 105)

Thereafter, and within the time allowed by the Rules of the Supreme Court of Indiana, the petitioner herein filed its Petition for Rehearing (R. p. 32, l. 36 to p. 33, incl.) which was denied by the Indiana Supreme Court on January 27, 1954 (R. p. 34, ll. 1 to 9), Emmert, J. and Draper, C. J. dissenting. The opinion, decision and judgment of the Indiana Supreme Court was rendered by the highest Court of the State of Indiana from which a decision could be had and is a final judgment, subject to no further review or correction in any other state tribunal.

The issue in this case and the holding of said Court, of which review is sought by this Honorable Court, draws in question the validity of a state statute and regulations thereunder on the grounds of being repugnant to the United States Constitution, viz: The Commerce Clause, Article I, Section 8, Clause 3.

The statutory provisions believed to sustain the jurisdiction of this Honorable Court are: Section 1257 (3) and Section 2101 (*e*) of Title 28 of the U. S. Code Annotated.

The Questions Presented

I

Does interstate commerce immunity extend to the taxation of capital *gains* derived from marginal stock transactions, such gains consisting of the gross *difference* between the cost of the property upon acquisition by the taxpayer and the gross receipts from its sale, with no deduction permitted for transactions in which the taxpayer may have sustained a loss by sale of corporate stock at less than the purchase price, the recipient of such gains being a resident of the State seeking to tax?

II

Are capital gains from marginal stock transactions derived from interstate commerce when there is no evidence that the recipient of such gains ever owned specific, identifiable shares, or that any stock ever crossed state lines, or that such recipient ever performed any act in interstate commerce?

Petitioner's Specification of Error

1. The Indiana Supreme Court, in its majority opinion, erred in having considered the receipts herein taxed as gross receipts from interstate sales, whereas said receipts admittedly consisted of "capital gains" from investments made by respondent, a resident and domiciliary of Indiana, the State seeking to tax.

2. The Indiana Supreme Court, in its majority opinion, erred in having considered the case of *Freeman* v. *Hewit*, 1946, 329 U. S. 249; 67 S. Ct. 274; 91 L. Ed. 265, as controlling,—said authority being applicable to a gross receipts tax imposed upon gross proceeds from interstate sales, whereas the instant case concerns a gross earnings tax imposed upon capital gains from investments made by respondent, a resident and domiciliary of Indiana, the State seeking to tax.

3. The Indiana Supreme Court, in its majority opinion, erred in holding that a tax on capital gains or gross earnings, remaining after the deduction of costs of acquisition, is subject to the same objections, under the Commerce Clause, as a tax imposed upon gross receipts without any deductions whatsoever.

4. The Indiana Supreme Court erred in holding that the transactions resulting in the capital gains herein taxed were in interstate commerce, when there is no evidence that re-

spondent was required to perform or performed any act in interstate commerce.

Reasons Relied Upon For the Allowance of the Writ

The final opinion, decision and judgment of the Indiana Supreme Court, rendered by the highest court of the State of Indiana in which a decision could be had, draws in question the validity of a state statute and regulations thereunder solely on the ground of being repugnant to the Federal Constitution, viz: the Commerce Clause. Said Court has decided a federal question of substance not heretofore determined by this Court, and in a way probably not in accord with applicable decisions of this Court.

1. As stated in this case by the dissenting opinion:

> "The net effect of the majority opinion is a decision that a net income tax assessed against a resident of Indiana upon his capital gains realized from sales of common stock on the New York Stock Exchange, when the certificates remained in New York, violates the Commerce Clause of the Federal Constitution."

This is contrary to well established, long standing and currently applicable precedents of this Honorable Court. The sole authority for the majority opinion is the well known case of *Freeman* v. *Hewit* (1946) 329 U. S. 249; 67 S. Ct. 274; 91 L. Ed. 265, which concerned a gross receipts tax as applied to the unapportioned gross proceeds from interstate sales.

In the *U. S. Glue Co.* v. *Oak Creek* (1918) 247 U. S. 321; 38 S. Ct. 499; 62 L. Ed. 1135, this Court recognized and explained the manifest and substantial difference between a tax measured by gross receipts and one measured by net income when it was held:

> "The difference in effect between a tax measured by gross receipts and one measured by net income, rec-

ognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude and *irrespective of whether it is profitable or otherwise.* Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. *A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large.* Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States." (Emphasis supplied)

(247 U. S. 321, at pp. 328, 329)

In *Atlantic Coast Line* v. *Daughton* (1923) 262 U. S. 413; 43 S. Ct. 620; 67 L. Ed. 1051, the question was whether an income tax law of North Carolina was unconstitutional under the Commerce Clause because certain deductions were not allowed the taxpayer, the argument being that the State's definition of net income differed from that adopted by the Interstate Commerce Commission. In upholding the tax in that case, this Court, in footnote (6) of 262 U. S., at p. 422, said:

"'[6] The term 'net income' in law or in economics, has not a rigid meaning. Every income tax act neces-

sarily defines what is included in gross income; what deductions are to be made from the gross to ascertain net income; and what part, if any, of the net income is exempt from taxation. These details are largely a matter of governmental policy. As to them States differ; and there is apt to be difference of view in the same States at different times; and at the same time a different definition of taxable net income for different classes of taxpayers. Obviously such differences in detail do not render obnoxious to the commerce clause a state income tax which is otherwise unobjectionable."

In *Freeman* v. *Hewit*, *supra*, upon which the majority opinion herein is solely grounded, this Court admonished that:

"* * * especially in this field opinions must be read in the setting of the particular cases and as the product of preoccupation with their special facts."
(329 U. S. at p. 252)

Further, in the *Freeman* v. *Hewit* case, *supra*, this Court recognized the vitality of *U. S. Glue Co.* v. *Oak Creek* and *Atlantic Coast Line* v. *Daughton*, *supra*, when it said:

"It can tax the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce. *U. S. Glue Co.* v. *Oak Creek*, 247 U. S. 321; cf. *Atlantic Coast Line* v. *Daughton*, 262 U. S. 413."
(329 U. S. at p. 255)

Examining the "special facts" of the case herein, we believe the majority opinion does violence to the principle of *Freeman* v. *Hewit*, *supra*, upon which it relies solely. The fundamental error of the Indiana Supreme Court, in its majority opinion, is its assumption that the receipts herein taxed were gross proceeds from interstate sales. *There is no evidence in the record that gross proceeds from*

sales were used as the basis upon which the tax was imposed. Instead, the respondent admitted by stipulation that the income upon which the tax was imposed was voluntarily paid by him upon the receipt of "capital gains." The tabulation of income received by respondent in each year demonstrates, without doubt or contradiction, that it was *gain* rather than gross proceeds of sale upon which the respondent paid tax. (R. p. 16, l. 25 to p. 21, l. 8).

The important and controlling factual difference, therefore, between the *Freeman-Hewit* decision and the instant case, does not merely relate to the method of financing, as the majority opinion states. *The material difference between the two cases relates to the nature of the income taxed.* The *Freeman-Hewit* decision holds that a gross receipts tax upon each and every dollar received as the sales price is a direct burden on interstate commerce, for the reason that it affects each transaction in proportion to its magnitude, whether the sale results in a profit or loss; that such a tax could conceivably be sufficient to make the difference between profit and loss and could thereby impede, discourage or destroy interstate commerce.

In contrast, no tax attaches in the instant case unless *profits* are realized. The greatest factor from which a loss could be sustained in these transactions, namely, *the cost of acquisition, is allowed as a deduction.* The basis of the tax is the *gross difference* between the cost of the property upon acquisition by the taxpayer and the gross receipts from its sale. This clearly withdraws the tax base from that of gross receipts to that of gross *profits.* And, as stated in the *Daughton* case, *supra,* since the term "net income" does not have a rigid meaning, the State does have the right to assert what deductions may or may not be allowed in determining taxable *earnings;* the fact that

other deductions are not allowed does not render the instant tax any the less a net income or earnings tax.

Since the tax herein attaches only upon the receipt of *gain*, it could have no greater deterrent effect upon interstate commerce than the same tax upon respondent's receipt of dividends from the same stock, even though that stock be situated without the taxing state. The factors which justify the tax are: *First*, the receipts are gains,—which are more nearly income in the true sense of that term; *the tax alone cannot convert gain into loss*, as in the case of a tax on gross receipts; *second*, the recipient of those gains is a resident and domiciliary of Indiana, the taxing State. We respectfully urge that the receipts herein taxed are as equally real income, in the true sense of the term, as dividends or interest, the receipts of which are taxable to Indiana residents irrespective of the situs of the stocks or bonds from which such earnings are derived. (Indiana Acts of 1937, Chapter 117, Section 1 (m), as amended, Burns' Indiana Statutes, Section 64-2601 (m)).

Since the only transactions subject to the tax herein are those in which profits were realized, the tax is not a direct burden on interstate commerce, since no tax is due if the transaction results in a loss. We submit, therefore, that *Freeman* v. *Hewit*, *supra*, the sole authority upon which the majority opinion is grounded, is not applicable to the "special facts" herein and that the Indiana Supreme Court, in its majority opinion, has failed to recognize a material and controlling factual distinction between that case and this, thereby extending the application of the *Freeman-Hewit* decision far beyond that intended by this Court.

2. Since the tax in the instant case is upon gain, the question of whether the taxpayer is engaged in interstate commerce should not be material. However, we believe the Indiana Supreme Court has extended the meaning of inter-

state commerce, for tax purposes, beyond that intended by the Commerce Clause as interpreted by this Court in the *Freeman-Hewit* case. In that case, this Court likened the stock certificates to the machines in *Adams Mfg. Co.* v. *Storen* (1938) 304 U. S. 307; 58 S. Ct. 913; 117 A. L. R. 429; 82 L. Ed. 1365, holding that it was no less interstate commerce because the property sold *and transmitted across state lines* was stock certificates rather than tangible personal property.

In the instant case, there is no evidence that respondent ever possessed or owned specific, identifiable shares of stock. It was stipulated that:

> "The stock certificates were never ordered out or transferred to the claim of the claimant. Neither were they ever delivered to the claimant in a street name. But the property interest in the stock was maintained in what is commonly called a margin account."
> (R. p. 21, ll. 14-19)

In this case, clearly the respondent is not shown to have transmitted stock certificates possessed by him across state lines as in *Freeman* v. *Hewit*. *There is no showing herein that the delivery of the stock sold necessitated the crossing of state lines.* Who can say with certainty that the shares sold by respondent crossed state lines? Is it not just as logical to assume that the purchasers resided in the same state in which the securities were held, at least in many instances?

On this point we refer the Court to *Ware & Leland* v. *Mobile County*, (1908) 209 U. S. 405; 28 S. Ct. 526; 52 L. Ed. 855, as being most similar to the instant case except that it concerned the selling of cotton future contracts on margin. In that case this Court emphasized that there was no contract for nor actual delivery of cotton; that no specific cotton was contemplated; that if delivery were required, it

could be acquired and delivered in one and the same state. In that case, this court upheld a state license tax on the broker engaged in multistate activities because there was not necessarily any movement of commodities in interstate traffic. If such a broker is not engaged in interstate commerce, the activities of the customer would seem to be one step further removed. The customer's activities are those of local communication with a local broker. The transmission of securities across state lines as in *Freeman-Hewit* is an essential element lacking from the fact pattern herein.

In *Western Livestock* v. *Bureau* (1938) 303 U. S. 250, at p. 253; 58 S. Ct. 546; 115 A.L.R. 944; 82 L. Ed. 823, this Court said:

> "That the mere formation of a contract between persons in different states is not within the protection of the commerce clause, at least in the absence of Congressional action, *unless performance is within its protection*, is a proposition no longer open to question." (Emphasis supplied)

We do not overlook the fact that marginal transactions are subject to Federal regulation, primarily, we believe, to prevent the excessive use of credit. However, in striking the balance between Federal and State power, this Court has recognized that Federal regulation does not in all cases preclude the right of a State to tax. Nor does such regulation in all cases determine that activities of individuals so regulated are interstate rather than local for tax purposes. Examples of this are found in the coverage of the Federal Wage and Hour Law which includes many individuals performing local activities in so far as state taxation is concerned. With respect to marginal transactions, the Federal regulation is directed to the level of the securities exchanges and only indirectly upon the customer. In this case, since performance in interstate commerce was not shown to have

been required of respondent, we submit that his activities are no more interstate than those of an individual dealing with a local, federally regulated bank. We believe that this reasoning is in accord with *Freeman* v. *Hewit* wherein the taxpayer was held to have been engaged in interstate commerce apparently because of the interstate shipment of his wholly owned securities, rather than for the reason that he was dealing with a federally-regulated broker.

Conclusion

This case presents still another phase of the Indiana Gross Income Tax Act of 1933, as amended,—in our opinion unlike the *Adams, Freeman-Hewit* or any other cases decided under that Act. Long before *Freeman-Hewit,* in fact, since July 1, 1934, income from marginal transactions has been taxed on a gross earnings as distinguished from a gross receipts basis. For years, other classes of taxpayers have by statute been accorded the gross earnings basis. Throughout the years, the Indiana General Assembly has extended the gross earnings basis to numerous classes of taxpayers, both before and since *Freeman-Hewit,* such amendments often having been sponsored by the class affected. Until this case, no one has seriously believed that such a tax violated the Commerce Clause.

This basis is believed to be justified by the fact that the activities of such classes of taxpayers result in a very narrow margin of profit, over which the taxpayer in many instances has no control. For example, dealers in securities are limited in their income producing possibilities by the fact that the market fluctuates from day to day, in some instances, only a fraction of a point. Certain of such taxpayers by various regulatory measures, Federal and State, are limited in the amount of interest or other income which they may charge. Others are limited to a specific margin

fixed by certain regulatory bodies over which such taxpayer has no control. The classes of taxpayers accorded the gross earnings basis do not have that free rein of other taxpayers to enter into a competitive field without restriction, who have only the law of supply and demand by which to fix their selling prices, which, in some instances, may reflect a profit varying from forty to one hundred percent of the cost of the merchandise sold. *Also taxpayers accorded the gross earnings basis often do not receive, control nor have the right to control the entire gross proceeds of the transaction as in this case;* in other words, that which they receive is gain rather than gross proceeds. It is for the above reasons that the Act defines gross income in many instances to mean gross earnings.

For instance, Section 3 (h) of the Act, Burns Indiana Statutes, Section 64-2603 (h) specifically accords the gross earnings basis to public terminal grain handlers, stating that "gross earnings shall be construed to mean the gross receipts from sales of such grain and soy beans, less the cost of grain and soy beans sold during such period, without any deduction of any other kind or character."

Section 3 (i) of the Act, Burns Indiana Statutes, Section 64-2603 (i) specifically accords the gross earnings basis to sales of grain when the federal government regulates both purchase and selling price, stating that the tax shall be equal to one percent (1%) of the *margin.*

Section 1 (n) of the Act, Burns Indiana Statutes, Section 64-2601 (n) accords the gross earnings basis to banks, trust companies, building and loan associations, brokers, dealers in securities, finance companies, dealers in commercial paper, persons engaged in the business of lending money or credit, and that section was amended by the Indiana Acts of 1953, Chapter 200, p. 753 to now include investment companies regulated under the Federal Investment Company Act of 1940, as amended.

The decision of the Indiana Supreme Court, by its majority opinion, is, therefore, of more vital importance than the precise issue herein. The import of that decision is to invalidate the gross earnings basis of the tax with respect to all taxpayers so reporting, wherever interstate, extra-state or multistate elements are present.

If the dividends received by respondent from the same securities herein are subject to the tax, as the Indiana Act indicates, even though the securities may have been held outside Indiana, we believe that the gains herein are as equally real income, in the true sense of that term, and not subject to interstate commerce immunity.

WHEREFORE, your petitioner respectfully prays that this Petition for a Writ of Certiorari be granted, that a review of the case herein be made by this Honorable Court, and that the majority opinion, decision and judgment of the Indiana Supreme Court be in all things reversed, and for such other relief in the premises as to this Honorable Court may seem meet and just.

Respectfully submitted,

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APPENDIX "A"

The majority opinion of the Indiana Supreme Court as pronounced by FLANAGAN, J., on December 15, 1953, and reported unofficially in 116 N. E. (2d) 104, is as follows:

FLANAGAN, J.:

"In the case of *Freeman v. Hewit* (1947), 329 U. S. 249; 67 S. Ct. 274; 91 L. Ed. 265, the Supreme Court of the United States decided that an Indiana citizen who bought stock on the New York Stock Exchange was engaged in interstate commerce, and therefore was not subject to tax on those transactions under the Gross Income Tax Law of the State of Indiana. In that case the Indiana citizen actually bought and paid for the stock.

"The question here presented is whether that decision governs buying on margin.

"The factual difference, as we understand it, is that when stock is bought on margin the broker advances a percentage of the purchase price, holds a lien on the stock for his advancement, and does not permit the stock certificate to be put in the name of the customer unless the customer pays in full, which rarely happens.

"This factual difference merely relates to the method of financing.

"However, the State of Indiana contends that transactions of this kind are only matters of bookkeeping; that since the stock certificates themselves do not cross state lines, no question of interstate commerce is involved.

"We cannot agree. Importance cannot attach to whether a piece of paper goes over state boundaries. Importance must attach to whether the *transaction itself* was a part of interstate commerce.

"As the Supreme Court of the United States pointed out in the case of *Freeman* v. *Hewit, supra*, the vital question in each case is whether the *sale itself* was in the field of inter-state commerce. The evidence of the transaction may float around the world or stay safely buried in a gilded vault on Wall Street. It seems to us to make no decisive difference.

"The trial court held that the facts in this case bring it within the rule laid down in the *Freeman* case. We think the trial court was correct.

"Judgment affirmed."

EMMERT, J. dissents with an opinion; DRAPER, C. J. concurs in dissent.

APPENDIX "B"

The dissenting opinion as pronounced by Emmert, J., and in which Draper, C. J., concurred on December 15, 1953, reported unofficially in 116 N. E. (2d) 104, at 105, is as follows:

EMMERT, *J.*:

"The net effect of the majority opinion is a decision that a net income tax assessed against a resident of Indiana upon his capital gains realized from sales of common stock on the New York Stock Exchange, when the certificates remained in New York, violates the Commerce Clause of the Federal Constitution. This contravenes the ruling precedents of the Supreme Court of the United States, which are binding on this court, on the right of the states to impose taxes which are not in violation of the Commerce Clause.

The appellee, hereafter referred to as the taxpayer, was a resident of and domiciled in Indiana and in the years 1944, 1945 and 1946, through two brokerage firms who had branch offices in Indiana, bought and sold corporate stocks on the New York Stock Exchange. The stocks here involved were bought and sold on a margin account, the certificates being taken in a street name, and held by the brokers in New York as agents for the plaintiff. The certificates were pledged to the brokers as security for any indebtedness that might be owing from the taxpayer to his brokers. Under the stipulation made in the trial court by the appellant, hereinafter referred to as Indiana, and the taxpayer, the differ-

ence between the sale price, and the purchase price paid by the taxpayer at the time of acquisition, resulted in a gain in each transaction in the total sums as follows:

Years	*Numbers of sales*	*Shares Sold*	*Gains*
1944	32	3,310	$ 8,839.74
1945	31	3,200	14,699.82
1946	13	1,250	7,425.44

No losses sustained by the taxpayer from the sale of any corporate stock were deducted from these gains. The taxpayer allocated his $1,000 deduction under Section 64-2605 (b), Burns' 1951 Replacement, to other transactions, and asserted in the trial court he was entitled to a refund for taxes paid as follows:

1944 claimed refund	$ 88.39
1945 claimed refund	146.99
1946 claimed refund	76.63
Total claimed refund	$311.51

We are not concerned in this appeal with the validity of Regulation 1005 since the taxpayer paid the taxes in dispute under the assumption that it applied to him, and Indiana asserts that this regulation furnishes the basis for computing the taxes owed for the respective years.

We should not let the decision in this case be influenced by the name given the Act by the General Assembly.[1]

"In passing on the constitutionality of a tax law 'we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it.' *Lawrence* v. *State Tax Comm'n*, 286 U. S. 276, 280; *Southern Pacific Co.* v. *Gallagher*, 306 U. S. 167, 177; *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435."

Nelson v. *Sears, Roebuck & Co.* (1941), 312 U. S. 359, 363; 61 S. Ct. 586; 85 L. Ed. 888; 132 A.L.R. 475.[2]

In considering the validity of the various provisions of the Indiana Act, the Supreme Court of the United States has held that the provisions then before it substantially imposed a tax on gross receipts, and was therefore analogous to a sales tax.

Adams Mfg. Co. v. *Storen* (1938, 304 U. S. 307, 311, 58 S. Ct. 913, 82 L. Ed. 1365, 117 A. L. R. 429;
Harvester Co. v. *Dept. of Treasury* (1944), 322 U. S. 340, 64 S. Ct. 1019, 88 L. Ed. 1313;
Freeman v. *Hewit* (1946), 329 U. S. 249, 67 S. Ct. 274, 91 L. Ed. 265.

However, under the law and the facts in this appeal the tax asserted by Indiana is not a gross receipts tax under any possible definition of the term. It is a tax upon the capital gain in each transaction, with no deduction permitted for transactions in which the taxpayer may have sustained a capital loss by sale of corporate stock at less than the purchase price. Therefore the decisions in

Adams Mfg. Co. v. *Storen* (1938), 304 U. S. 307, 311; 58 S. Ct. 913, 82 L. Ed. 1365, 117 A. L. R. 429, *supra.*

and

Freeman v. *Hewit* (1946), 329 U. S. 249; 67 S. Ct. 274; 91 L. Ed. 265, *supra.*

establish no basis for holding the taxpayer immune from the Indiana tax on his capital gains.

In substance, Indiana has sought to impose a net income tax on the capital gains transactions realized on a margin stock account, by an Indiana resident domiciled in this state. The fact that from an accounting standpoint the taxpayer had other costs in the transactions which he may not deduct for the purpose of computing the tax, does not make the tax any the less a net income tax. It could hardly be contended that Sec. 23 (h) of Ch. 1 of the U. S. Internal Revenue Code, 26 U.S.C.A., Sec. 23 (h), which provides

that, "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions", makes the Act a tax on gross receipts. See also Sec. 117 (d) of Ch. 1 of the U. S. Internal Revenue Code, 26 U. S. C. A. Sec. 117 (d).[2]

"The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the State are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States."

U. S. Glue Co. v. *Oak Creek* (1918), 247 U. S. 321, 328, 329; 38 S. Ct. 499; 62 L. Ed. 1135.

The Indiana tax in controversy here violates neither the Commerce Clause nor the Fourteenth Amendment of the Federal Constitution.

The judgment of the trial court should be reversed.

DRAPER, C. J., concurs in this opinion.

NOTES:

(1) "This act may be cited as the Gross Income Tax Act of 1933." Section 64-2601, Burns' 1951 Replacement.

(2) "Indeed, if we are to remain concerned with the practical operation of these state taxes rather than with their descriptive labels (*Nelson* v. *Sears, Roebuck & Co.* 312 U. S. 359, 363), we must acknowledge that the sales tax sustained in the *Berwind-White* case 'was, in form, imposed upon gross receipts from an interstate sale.' Lockhard, Gross Receipts Taxes on Interstate Transportation and Communications, 57 Harv. L. Rev. 40, 87." Harvester Co. v. Dept. of Treasury (1944), 322 U. S. 340, 346; 64 S. Ct. 1019, 88 L. Ed. 1313.

(3)(1) "In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) "In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. If the tax is to be computed under Supplement T, 'net income' as used in this paragraph shall be read as 'adjusted gross income'. Section 117(d), Ch. 1, U. S. Internal Revenue Code, 26 U. S. C. A. Sec. 117 (d)."

APPENDIX "C"

Pertinent provisions of the Indiana Gross Income Tax Act bearing on issues presented herein, are as follows:

Section 3(f):

> "With respect to that part of the gross income of every person received from operating any bank, trust company, building and loan association, insurance and/or casualty company, finance company, small loan company, or any other business of a similar nature, in-

cluding all others mentioned in subsection (n) of section 1 (Sec. 64-2601), the tax shall be equal to one (1%) percent of such part of the gross income."

(Acts 1933, ch. 50, Sec. 3, p. 388; 1937, ch. 117. Sec. 3, p. 604; 1941, ch. 140, Sec. 2, p. 418; 1945, ch. 310, Sec. 1, p. 1380.)

Burns' Indiana Statutes Anno. Sec. 64-2603.

Section 1(n):

"In the case of banks, trust companies, building and loan associations, investment companies, regulated under the federal investment company act of 1940 as amended, brokers, dealers in securities, finance companies, dealers in commercial paper, and persons engaged in the business of lending money or credit the term 'gross income' shall be deemed to mean gross earnings, but only in respect to that part of the total gross income of such persons which is derived from the businesses and activities enumerated in this subsection."

(Acts 1933, ch. 50, Sec. 1, p. 388; 1937, ch. 117, Sec. 1, p. 604; 1941, ch. 140, Sec. 1, p. 418; 1943, ch. 144, Sec. 1, p. 425; 1945, ch. 143, Sec. 1, p. 311; 1947, ch. 370, Sec. 1, p. 1471; 1953, ch. 200, Sec. 1, p. 747.)

Burns' Indiana Statutes Anno. Section 64-2601.

Section 3 (h):

"With respect to that part of the income of every person which is derived solely from the purchase and sale of whole grain and soy beans by such person in the capacity of a public terminal grain handler engaged in the business of receiving, processing, storing, and merchandising whole grain and soy beans in markets having full transit privileges, the tax shall be equal to one (1%) per cent of the gross earnings, computed upon an annual basis, derived from such sales of grain and soy beans. Provided, however, that for the purpose of this subsection only, gross earnings shall be construed to mean the gross receipts from sales of

such grain and soy beans less the cost of grain and soy beans sold during such period, without any deductions of any other kind or character. Provided, further, that nothing herein contained shall be construed to authorize the computation of the tax due under this act, measured by gross receipts of such persons from storage, cleaning, service or handling charges, or any other receipts except those from sales of whole grain and soy beans on a gross earnings basis."

(Acts 1933, ch. 50, Sec. 3, p. 388; 1937, ch. 117, Sec. 3, p. 604; 1941, ch. 140, Sec. 2, p. 418; 1945, ch. 310, Sec. 1, p. 1380.)

Burns' Indiana Statutes Anno., Section 64-2603.

Section 3 (i):

"With respect to that part of the income of every person which is derived solely from the purchase and sale of whole grain and/or soy beans when the United States government, by any authorized officers, department of (or) agency, has by any law, rule, regulation or directive, prescribed both a purchase-price and a sale price thereby creating a specific margin between such purchase-price and such sale price, the tax shall be equal to 1% of such specific margin."

(Acts 1933, ch. 50, Sec. 3, p. 388; 1937, ch. 117, Sec. 3, p. 604; 1941, ch. 140, Sec. 2, 418; 1945, ch. 310, Sec. 1, p. 1380.)

Burns' Indiana Statutes Anno., Section 64-2603.

Section 1 (m):

"* * * Provided, further, That with respect to individuals resident in Indiana and corporations incorporated under the laws of Indiana authorized to do and doing business in any other state and/or foreign country, the term 'gross income' shall not include gross receipts received from sources outside the state of Indiana in cases where such gross receipts are received from a trade or business situated and regularly carried on at a legal situs outside the state of Indiana, or from activities incident thereto (including the disposal of

capital assets or other properties which had been theretofore acquired or used in carrying on such trade or business): Provided, further, That it is not the intention by the foregoing language to exclude from the definition of 'gross income' any receipt of a taxpayer received as interest or dividends, or from sales or other receipts received from investments, which investments were acquired and/or disposed of other than in connection with the business in which such taxpayer is regularly engaged, nor shall this exclusion be construed as applying to salaries, wages, bonuses, commissions, or other personal remuneration of any kind or character received by any taxpayer."

(Acts 1933, ch. 50, Sec. 1, p. 388; 1937, ch. 117, Sec. 1, p. 604; 1941, ch. 140, Sec. 1, p. 418; 1943, ch. 144, Sec. 1, p. 425; 1945, ch. 143, Sec. 1, p. 311; 1947, ch. 370, Sec. 1, p. 1471; 1953, ch. 200, Sec. 1, p. 747.)

Burns' Indiana Statutes Anno. Section 64-2601.